LIBERTY MINES INC.

A Growing Producer of Nickel

April 26, 2007

President's Letter to Shareholders

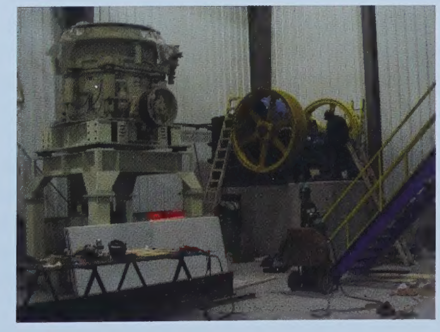
2006: A Year of Many Accomplishments






On behalf of the Board of Directors, I am pleased to present our Annual Report for the year 2006. This was a year of many accomplishments which provided the foundation for a growing mining enterprise for many years to come with a focus on the permitting and construction of a new nickel concentrator at the Redstone mine site.

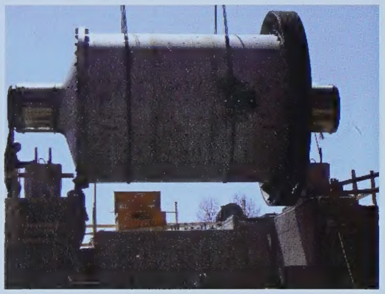
After exhausting all feasible alternatives, the decision to build the Redstone mill to produce nickel in concentrate was made in February. Permitting for the 1500 tonne per day mill formally began March 26 with interministerial and First Nation meetings. Despite the suggestions at those meetings that it normally takes two years to obtain the extensive permits required for a new mill, management persisted and Liberty was awarded all major permits for the mill during the period from late September to early November. Construction of the mill foundations began in the first week of October. By the end of the year, the crusher building was nearing completion and the foundations for the mill building were well underway. The tailings dike area was cleared and the first layer of rock was installed around the perimeter of the dike. That provided a road from which to start the installation of the clay key in the first quarter of 2007. All major crushing and mill equipment was purchased throughout the year to enable the mill to be operational in the second quarter of 2007. A new larger steel structure for the mill building was also purchased along with a third ball mill to ensure that the capacity of the mill would handle 2000 tonnes of ore per day. That would allow for a 33% increase in production after successfully obtaining an amendment to the existing mill permits.



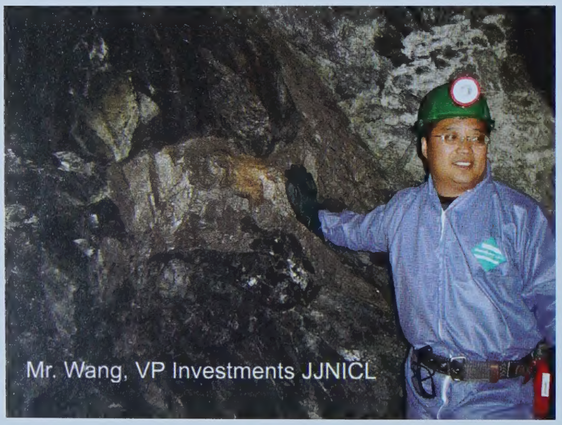
*"**The 100% owned Redstone Mill allows the Company to sell its concentrate internationally with complete control over the operations of the mill. Its modern equipment is optimal for the concentration of nickel sulfides from komatiite ore.**"*



The 100% owned Redstone Mill allows the Company to sell its concentrate internationally with complete control over the operations of the mill. Its modern equipment is optimal for the concentration of nickel sulfides from komatiite ore. Operated by our very qualified staff, it will produce maximum metallurgical recoveries and therefore enhanced revenues. The mill is centrally located among our extensive Shaw Dome nickel mining claims and will process all feed from the mines we have, will discover, or acquire in the area. Our financial destiny will no longer be determined by the need for a third party to process our ore.



Financings mainly for development at the Redstone mine and construction of the Redstone mill were completed in March and October raising gross proceeds of $2,436,949 and $9,044,690 respectively.


Mr. Wang, VP Investments JJNICL

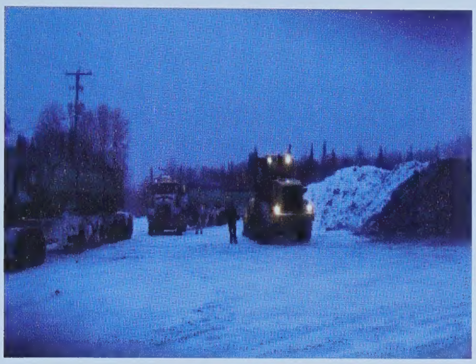
In April, Jilin Jien Nickel Industry Company Ltd. (JJNICL) of China graciously provided us a pre-payment of $4,000,000 US against nickel in concentrate which was to be produced for them within one year. By mid April 2007, we provided the amount of nickel in concentrate necessary to pay back the prepayment in accordance with our agreement. Management is very grateful for the financial help and other cooperation JJNICL has provided to us.

At the Redstone nickel mine, new electric facilities were installed and energized in April. Minor rehabilitation of the mine was accomplished from January to May after dewatering of the mine was completed in late December 2005. Pre-commercial production began mid May with ore being shipped to SMC (Canada) Ltd. in Cobalt Ontario for custom milling. The decision to hire our own miners for ore development and mining at the Redstone mine was made to optimize the operations. The Company also bought its own scoop-trams, loaders, man carriers and mine trucks.

Definition drilling from the 700 foot (213m) level to the 1500 foot (457m) level commenced in September and was completed in March 2007. The drill data, mine plan and economics for this part of the mine will allow a 43-101 reserve calculation to be completed by SRK Engineering. It will also provide part of the requirements for Liberty to graduate to the TSX from the TSX Venture exchange.

The first shipment of nickel in concentrate to China from the custom mill was made July 5. In late October, SMC (Canada) Ltd. advised that they had to temporarily shut down their facilities. Their ball mill liners had to be removed and replaced with new liners on order before they could re-commence milling our ore. No concentrate was able to be shipped to JJNICL during the shut-down which caused a severe reduction of the cash flow projected for the fourth quarter. However, the mill was operational again in early December with better recoveries and concentrate grade.

Studies for the permitting of the McWatters nickel mine 9 kilometers east of the Redstone mine were completed throughout the year. Permits for a new road to the mine which passes through the Hart project were obtained. The McWatters mine is projected to be in production in third quarter of 2007 with production ramping up to 1200 tonnes per day as explained below. Both mines will provide feed to allow the Redstone mill to operate at full permitted capacity.



The Hart nickel project was purchased in July. This is a very prospective property as a candidate for Liberty's third nickel mine. The west Redstone 104 claim block was also acquired in June. These mining claims added significant exploration potential to the west of the Redstone mine.

The Shaw Dome nickel belt is relatively under-explored. Aside from the Langmuir #2 mine owned by Noranda/Inco in the early 1970's which produced approximately 1,300,000 tons of ore grading 1.45% nickel and the Redstone mine which operated for 2 ½ years to produce 276,000 tonnes of ore grading 2.4% nickel, there has been very little production. The geology of the Shaw Dome is very similar to that of Kambalda Australia where about 40 mines have been discovered since the 1960's. The tonnages of these types of deposits are not generally large, but are very economic because of the higher grades. Liberty owns over 12,000 hectares of contiguous mining claims around the Shaw Dome and has elucidated dozens of drilling targets. The Company will very likely be known as a nickel producer from **many** smaller mines (1.5 million tonnes or less) rather than a company with one or two larger mines. The overall tonnages could be very significant and afford Liberty less production risk from a sudden problem at any particular mine. On the other hand, there may be a larger deposit yet to be discovered. Certainly, the Redstone mine has the exploration potential to be a larger candidate. By the end of 2007, much more will be known about its structure.

"Successful results will make us unique in the mining industry as a primary producer of two different metals, nickel and cobalt."

On the cobalt front, two mining claims were purchased at McAra Lake adjacent and south of the main cobalt deposit. Limited drilling at the McAra Lake cobalt deposit continued to expand the deposit. The rich cobalt ore contains arsenic and there was little point for Liberty to spend a lot of money on developing the deposit without having a buyer for the ore to be mined from it. That problem was solved in March 2007 with the announcement of an off-take agreement with JJNICL for a cobalt-nickel concentrate and financial assistance to build another mill and possibly a hydrometallurgical facility. JJNICL continues to show strong support for our company and our strategic alliance grows ever stronger. They also support us in our endeavors to grow together through acquisitions made by Liberty to acquire more nickel and cobalt deposits.

An extensive drill program will begin at the McAra Lake deposit and the adjacent Ray Township surface trenches in the spring of 2007 to elucidate the structures. Successful results will make us unique in the mining industry as a primary producer of two different metals, nickel and cobalt.

Liberty is now a producer of nickel, and will continue to build its resources through exploration and acquisitions. With long term commodity prices for nickel and cobalt establishing a higher base, the future is very bright for Liberty.

On behalf of the Board of Directors, I would like to thank you for your financial support as we commit to build Liberty into a mid-tier producer of nickel and cobalt.

Sincerely,

Dr. Gary Nash, PhD (Physics), President and Chief Executive Officer, April 26, 2006

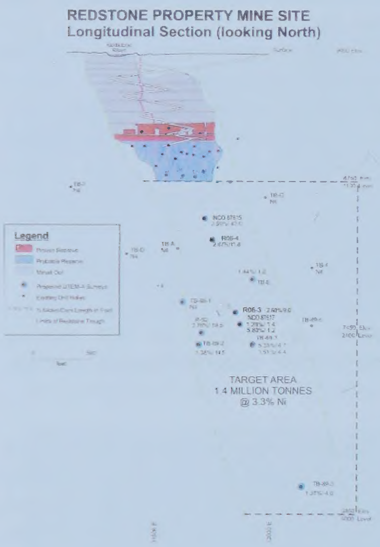
Properties and Projects

"Liberty is now a producer of nickel, and will continue to build its resources through exploration and acquisitions."

Nickel Projects

Redstone Mine

Pre-commercial production began at the mine mid May with an average rate of approximately 110 tonnes per day on a 7 day per week schedule. Ore was shipped to SMC (Canada) Ltd. for concentrating while the Redstone Mill was in the permitting and construction stages. The drill drift on the 700 foot (213m) level was extended so that a drill program from within the mine could be established to bring the historical reserves into compliance with NI 43-101 standards, and to add more reserves from the 1100 foot (335m) level to the 1500 foot level (457m). The drill program commenced in September and was completed in March 2007 with the reserve calculation by SRK Engineering expected to be completed in the second quarter of 2007.



The ramp was extended to the 900 foot (274m) level in January 2007 and is scheduled to continue to at least the 1200 foot (366m) level. With a shaft at the mine in the engineering stage and a construction timeline of several months to build the infrastructure and the upper part of the shaft, increasing production would be counter productive as costs to extend the ramp much deeper are better spent on the shaft. It is therefore anticipated that the production rate will be purposely below the desired minimum of 300 tonnes per day until the shaft is finished in 2008. A multi-compartment hoist is designed to allow coincident deepening of the shaft and ore hauling. Bringing the McWatters Mine into production will supply the tonnage shortfall from the Redstone to feed the new mill at full capacity and allow shaft development at the Redstone to proceed most efficiently.

Exploration of the deeper ore at the mine was tested with R06-03 hitting 2.74m of 2.60% nickel("Ni") 1989 feet (606m) vertically below surface; R06-4 intersected 3.60m of 2.07% Ni at 1530 feet (466m) and R06-01 was extended to yield 3.45m of 3.9% Ni at 2214 feet (675m) (as reported February 23, 2007). Drilling started late in the year to test the anomaly found by Inco in 2003 from a down-hole geophysical study of borehole 89-5 drilled by Timmins Nickel in 1989. Two deep holes and two wedge holes, one from each borehole, were completed subsequent to year end. All four holes contained Ni mineralization which confirmed the potential for the Redstone Mine to have a significant resource at depth.

McWatters Mine

The McWatters nickel deposit is located approximately 28 kilometers southeast of the city of Timmins, Ontario, in Langmuir Township and about 9.5 km east of the Redstone Mine. The McWatters deposit was originally planned to be mined as a surface pit. With the high nickel prices at year end, it was decided in early 2007 to mine the deposit as a long-hole operation to be able to reach the deeper rich ore body about one year sooner. Both the upper zone, defined by an NI 43-101 indicated resource of 496,500 tonnes grading 0.77% Ni and the lower rich zone averaging 2.77% nickel at approximately 120m below surface, can be mined together. This will optimize the economics over the approximate two year life of the mine should nickel prices start to drop throughout 2008-2009.

Production at McWatters is now slated for the third quarter of 2007, subject to the receipt of all mining permits. Ore will be removed from sill development on each level as the ramp extends to the lowest zone. This will allow approximately 500 tonnes per day to be removed from the upper zones with the ramp reaching the lower zone in about six months. Then, after another one to two months for development of the lower level, production at 1200 tonnes per day will begin from the rich zones. After the lower zone is exploited, mining of progressively higher levels will continue at that rate of production until the upper zones are mined out.

Five holes were drilled in early 2006 to attempt to define extensions to either the lower rich zone or the upper zone, or both. No extensions were found but it is still felt that the ore body may extend to the south west of the known ore zone. Drilling will test this hypothesis in 2007 as the ramp and surface developments are being constructed.

Hart Nickel Project

The Hart nickel project, purchased in July, consists of an historical resource of 700,000 tonnes at 0.9% nickel. Although the historical resource is not to be relied upon as it has not been drilled to National Instrument 43-101 standards, it is a very prospective property located between the producing Redstone mine and the McWatters mine. The historical drilling defines a minimum of four nickel sulphide shoots with a steep southerly plunge. Of the 26 historical holes documented on the zone, only 7 holes have been drilled below the 150 m level, with 24 of the holes restricted to testing 200 m of the strike extent of the 800 m long ultramafic embayment. Some of the historically reported boreholes are:

Hole #	Vertical Depth (m)	Core Length (m)	Ni (%)
NLX-64-1	44.20	1.13	1.24
NLX-64-5	44.20	4.57	2.10
NLX-64-7	103.63.	2.44	1.12
PAR-68-1	266.70	1.52	1.78
PAR-68-4	303.28	2.19	2.77
PAR-68-6	146.30	2.01	1.11

Drilling the deposit commenced in February 2007. Should the drill program be successful in proving up the historical resource, the Hart Mine would be scheduled to follow the depletion of the McWatters Mine as feed for the Redstone Mill.

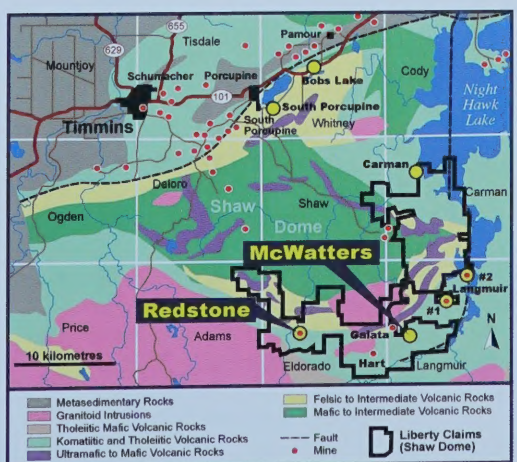
Galata Nickel Deposit

The Galata nickel showing is located about 2 km north-west of the McWatters Mine. Historical and recent grab samples of a surface exposure at the site have yielded 5%-7% Ni. The deposit has never been systematically drilled and is an excellent target to be drilled in 2007.

Langmuir #2 Mine

The mining claim which contains the shaft of the past producing Langmuir #2 nickel mine in Langmuir Township is 100% owned by Liberty. There are historical reserves of 255,000 tonnes of nickel ore grading 1.2% reported to remain in this part of the mine which is a future target to explore and possibly confirm to NI 43-101 standards. Liberty also owns the adjoining claim to the south east and another non-adjacent claim to the west of the main claim.

Shaw Dome Properties



Liberty owns over 12,000 hectares of mining claims centered on the south end of the Shaw Dome. The general area includes the Redstone, McWatters, Hart and Galata deposits. The west Redstone claims will be drilled mid 2007 to test for mineralization west of the Redstone Mine. The entire set of mining claims was flown by Aeroquest to construct an airborne geophysical survey of the properties in the first quarter of 2007. This survey, together with compiled historical data, has generated dozens of targets to be explored in detail over the next few years.

Cobalt Projects

McAra Cobalt Project

The McAra cobalt ore is incredibly rich with an average grade of about 2% cobalt compared to 0.5% cobalt in the primary copper-cobalt deposits in Africa, and much richer than the 0.02% cobalt ("Co") typically found as a byproduct of nickel mining. The property contains veins grading up to 11.74% Co as detailed in the October 1, 2004 press release (borehole EDS 04-07) and copper veins grading up to 11.9% copper ("Cu") over 3.1m (borehole EDS 04-05 drilled 27m east of EDS 04-07) as per the February 25, 2004 news release which must be traced and possibly extended.

Limited drilling this year extended the known zones of both the cobalt and copper mineralization. As stated in the May 31 news release, borehole M06-19 hit 4.81m of 1.8% Cu in the upper chalcopyrite zone and 1.11m of 1.5% Cu in the lower zone; M06-20 found 4.13m of 1.4% Cu and M06-21 yielded an upper zone with 3.57m of 1.27% Cu and a lower chalcopyrite vein of 1.08m with 1.92% Cu. These three holes were drilled approximately 65m east of EDS 04-5. Borehole M06-22 hit a lower zone of 9.84m of 1.23% Co, 13m below the rich Co vein in EDS 04-07. Borehole M06-27, approximately 71m from M06-19, returned a significant 19.46m intersection of 1.10% Co and 0.77% Cu including zones of 9.62% Co and 6.26% Cu (July 31 press release).

Subsequent to the year end in March 2007, an off-take agreement and undertaking to build a mill and hydrometallurgical facility to concentrate and remove the arsenic from the McAra ore was signed with JJNICL. This was a critical milestone which enabled the development of the cobalt properties to proceed. A cobalt-nickel concentrate will either be shipped and refined in China or refined in Canada depending on governmental restrictions in both countries with regard to imports and permits.

Cobalt, known as a strategic metal, is an important component in high quality batteries and high temperature steel alloys. It is also important in medical applications for artificial knees, hips and shoulders. With the advent of hybrid cars and aging baby boomers, there should be considerable future demand for the metal.

Ray Township Cobalt Claims

The adjacent Ray Township cobalt claims have several surface showings of approximately 0.3% cobalt and 0.3% nickel. This extensive property contiguous to the McAra cobalt discovery will be actively explored over the next two years and could provide feed for the McAra mill.

Gold Claims

Whitney Gold Claims

Liberty will explore these claims to ensure work assessment credits are available and the claims are in good standing. They are situated adjacent to the Goldcorp Porcupine Joint Venture gold deposit and are considered to have good exploration potential.

Management's Discussion and Analysis ("MD&A")

Year Ended December 31, 2006

Description of the Business

Liberty Mines Inc. (the "Company" or "Liberty") is a mineral exploration and development company with a focus on the development and production of nickel, cobalt and platinum group metals from its properties in Ontario. The Company's core projects are the Redstone Mine located 25 km south east of Timmins, Ontario in Eldorado Township; the McWatters Mine located in Langmuir Township, approximately 9.5 km east of the Redstone Mine; the Hart nickel project located approximately 6km east of the Redstone Mine and the McAra Lake Cobalt property, located in Dufferin Township, south of Shining Tree, Ontario.

This discussion should be read with the annual audited consolidated financial statements of Liberty Mines Inc. for the years ended December 31, 2006 and 2005 which were prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP"). All amounts are in Canadian dollars unless otherwise indicated. This MD&A contains certain forward looking statements based on management's current expectations (please see "Forward Looking Statements" below). This MD&A was prepared effective April 26, 2007.

Overall Performance

Liberty is a pre-production stage company in the process of exploring its properties and bringing those properties with economically recoverable ore reserves into production. It has also undertaken to build a technologically innovative nickel processing facility at the Redstone mine site which the Company believes will be commissioned in June of 2007. The Company will continue to rely on external sources of financing until sufficient revenues can be generated from mining activities to fund the accelerated exploration program and complete the construction of the Redstone mill. The Redstone mine is currently at the pre-production stage and the Company believes production will be achieved and declared in June of 2007 coincident with the commissioning of the mill. Liberty is now a producer of nickel, and will continue to build its resources through exploration and acquisitions.

Highlights for the year include:

- The Company brought the Redstone mine into pre-commercial production in May and the first shipment of nickel in concentrate to Jilin Jien Nickel Industry Company Ltd. ("JJNICL") of China from a custom mill in Cobalt Ontario was made was made in July. Minor rehabilitation of the mine was accomplished from January to May after dewatering of the mine was completed in late December 2005.

  The decision to hire our own miners for ore development and mining at the Redstone mine was made to optimize the operations. The Company also bought its own scoop-trams, loaders, man carriers and mine trucks.

  In late October, the custom mill facility advised that they had to temporarily shut down for maintenance. As a result, no concentrate was available for shipment to China during the shut-down which caused a severe reduction in cash flow for the fourth quarter. The mill was operational again in early December but no shipment of nickel concentrate to JJNICL was made until January of 2007. During the year, 14,495 tonnes of nickel ore was custom milled in Cobalt Ontario. This produced 285,000 lbs. of nickel which was shipped to JJNICL in receipt of US$2,542,000. Subsequent to the year end, the Company has received approximately US$4,769,000 from additional shipments of 386,000 lbs. of nickel;

  Definition drilling from the 700 foot (213m) level to the 1500 foot (457m) level commenced in September and was completed in March 2007. The drill data, mine plan and economics for this part of the mine will allow a 43-101 reserve calculation to be completed;

- Private placements were completed in March and October raising gross proceeds of $2,436,949 and $9,044,690 respectively. Proceeds are to be used for development at the Redstone mine and construction of the Redstone mill;

- In April, JJNICL provided a pre-payment of US$4,000,000 against nickel in concentrate. These funds were used to begin construction of the Redstone mill and tailings facility. During the year, the Company made US$150,000 of principal repayments. Subsequent to year end, the Company made principal payments to JJNICL with shipments of nickel concentrate valued at approximately US$3,365,000 and also provided the required principal repayments of US$50,000. The Company believes the balance of the loan will be paid in full within the next month;

- The decision to build the Redstone mill and tailings facility to produce nickel in concentrate was made in February. Permitting for the mill formally began in March. By late September to early November, Liberty was awarded all major permits for the mill allowing construction began in October. By the end of the year, the crusher building was nearing completion and the foundations for the mill building were well underway. The tailings dike area was cleared and the first layer of rock was installed around the perimeter of the dike. All major crushing and mill equipment was purchased throughout the year to enable the mill to be operational in the second quarter of 2007. A new larger steel structure for the mill building was also purchased along with a third ball mill to ensure that the capacity of the mill would handle 2,000 tonnes of ore per day.

  The Redstone Mill allows the Company to sell its concentrate internationally with complete control over mill operations. The mill is centrally located among our extensive nickel mining claims and will process all feed from the mines we have in the area;

- Studies for the permitting of the McWatters nickel mine 9 kilometers east of the Redstone mine were completed throughout the year. Permits for a new road to the mine which passes through the Hart project were obtained. The McWatters mine is projected to be in production in third quarter of 2007. Both mines will provide feed to allow the Redstone mill to operate at full permitted capacity;

- The Hart nickel project was purchased in July for an initial payment of $100,000 plus 100,000 shares valued at $77,000. The Company will earn a 100% interest in the 11-unit group of contiguous mining claims by paying $100,000 plus common shares valued at $100,000 and 100,000 warrants on the first and second anniversaries. This property is a candidate for Liberty's third nickel mine.

- The west Redstone 104 claim block was also acquired in June for 100,000 shares valued at $60,000 plus $25,000. Future payments of $243,000 and 125,000 shares over five years and annual work commitments of $100,000 are necessary to maintain the options. These mining claims added significant exploration potential to the west of the Redstone mine; and

- With respect to the Company's cobalt properties, two mining claims were purchased at McAra Lake adjacent and south of the main cobalt deposit for an initial payment of $40,000 plus payments of $40,000/year for the next two years. Limited drilling at the McAra Lake cobalt deposit continued. In March 2007 the Company announced an off-take agreement with JJNICL for a cobalt-nickel concentrate and financial assistance to build another mill and possibly a hydrometallurgical facility. An extensive drill program will begin at the McAra Lake deposit and the adjacent Ray Township surface trenches in the spring of 2007 to elucidate the structures.

Subsequent to year end, the Company:

- Signed an off-take agreement and undertaking to build a mill and hydrometallurgical facility to concentrate and remove the arsenic from the McAra project with JJNICL. This was a critical milestone which enabled the development of the cobalt properties to proceed. A cobalt-nickel concentrate will either be shipped and refined in China or refined in Canada depending on governmental restrictions in both countries with regard to imports and permits;

- Completed a private placement of units and flow-through common shares for gross proceeds of $12,100,000. The proceeds are for exploration and development activities for the Redstone, McWatters, Hart and Galata projects and capital purchases for the Redstone mine and mill;

- Purchased additional mining claims and one mining patent in the Shaw Dome nickel belt near Timmins, Ontario for a total of $106,000 plus 5,000 common shares and a 2% net smelter royalty; and

- Continued the construction of the Redstone mill and tailings facility.

The Company also had the following changes to its directors and officers:

- In April, Mr. Donald McKinnon Jr. resigned as a director and Mr. Gerry Feldman, C.A. and Mr. Carlo Cattarello were appointed as directors; and
- Subsequent to year end, Mr. Tom James resigned as CFO and a director and Mr. John Pinsent, C.A. was appointed as a director and Mr. Warren Cabral, C.A. was appointed as CFO. Also, Mr. Daniel Dumas resigned as a director and Mr. Gil Bertrand was appointed as a director.

Selected Annual Information

	Year Ended December 31, 2004	Year Ended December 31, 2005	Year Ended December 31, 2006
Net loss	$525,394	$656,502	$517,802
Loss per share	$0.02	$0.02	$0.01
Total assets	$3,163,012	$6,769,452	$28,318,700
Total long-term debt	Nil	Nil	$555,646

Note: i) The Company has not declared dividends. ii) The Company does not have any off-balance sheet arrangements.

Results of Operations

Liberty is a pre-production stage company in the process of exploring its properties and bringing those properties with economically recoverable ore reserves into production. Until such time as the Company brings a resource property into production, all costs associated with the exploration and development of the property will be deferred. As a result, the Company's statement of operations identifies those costs that are not deferred or costs that are not directly related to exploration and development of a specific resource property. The Company does provide a detailed analysis of exploration and developments activities on resource properties in the annual audited consolidated financial statements.

The Company's net loss for the year was $517,802 compared to $656,502 in the prior year. The change in loss includes an increase in operating expenditures of $349,196 compared to the prior year. The significant changes in operating expenses are as follows.

Salaries and Benefits and Consulting Fees

During the year ended December 31, 2006, the Company increased its compensation paid to the management team as a result of the increased nature of operations and the movement from individuals working as consultants to employees. Salaries and benefits for the year ended December 31, 2006 were $82,590 compared to $19,192 for the prior year, an increase of $63,398. Consulting fees and director's compensation for the year ended December 31, 2006 were $290,884 compared to $554,856 for the prior year, a decrease of $263,972. Included in consulting fees is stock-based compensation. During the year ended December 31, 2006, the Company granted 432,000 (2,150,000 – 2005) stock options with a weighted average exercise price of $.70 ($.34 – 2005). The fair value of each option granted was determined using the Black-Scholes option pricing model and $164,389 (2005 - $449,856) was credited to contributed surplus.

Foreign Exchange Loss

For the year ended December 31, 2006, foreign exchange loss was $149,299 compared to $nil in the prior year. During the year, the Company processed and sold nickel concentrate denominated in U.S. dollars. Exchange rate fluctuations from a stronger Canadian dollar resulted in the exchange loss.

Insurance

For the year ended December 31, 2006, insurance costs were $49,083 compared to $4,932 in the prior year, an increase of $44,151. This increase is from additional premiums associated with capital asset purchases for the Redstone mine and mill, plus additional premiums associated with general corporate liability insurance.

Interest and Bank Charges

For the year ended December 31, 2006, interest and bank charges were $40,325 compared to $nil in the prior year. The increase is from interest costs associated with significant capital leases the Company entered into during the year ended December 31, 2006. These leases were for mining equipment which is being utilized at the Redstone mine.

Summary of Quarterly Results

	Mar. 31, 2005	Jun. 30, 2005	Sep. 30, 2005	Dec. 31, 2005	Mar. 31, 2006	Jun. 30, 2006	Sep. 30, 2006	Dec. 31, 2006
Net loss	$39,415	$185,877	$55,574	$510,956	$152,104	$225,491	$55,573	$84,634
Loss/share	$0.00	$0.00	$0.00	$0.02	$0.00	$0.01	$0.00	$0.00

During the fourth quarter, Liberty remained a pre-production stage company and continued its policy of deferring all costs associated with exploration and development. During the quarter, the Company incurred additional costs associated with a private placement which raised gross proceeds of $12,100,000 and additional interest charges associated with new mining equipment purchased using capital leases.

Liquidity

The Company has been successful in raising sufficient capital to fund operations for the 2006 fiscal year. On March 7, 2006 the Company completed a non-brokered private placement of 3,293,785 flow-through shares at $0.70 and 202,000 units consisting of one common share and one-half warrant for gross proceeds of $2,436,949. On October 24, 2006 the Company completed a private placement of 6,350,266 flow-through shares at $0.90 per share and 3,917,000 units at $0.85 per unit, each unit consisting of one common share and one-half warrant for gross proceeds of $9,044,690. In November, the Company announced the acceleration of the exercise date of the warrants issued pursuant to the March private placement. Subsequent to year end, the Company completed a non-brokered private placement of 3,293,785 flow-through shares at $0.70 and 202,000 units consisting of one common share and one-half warrant for gross proceeds of $12,100,000. The Company also raised $1,089,238 from the exercise of stock options and warrants.

During the year, the Company partially financed the purchase of mining equipment utilizing capital leases. At December 31, 2006, total capital lease obligations were $969,303.

The Company will continue to rely on various forms of funding until sufficient cash flow is obtained from mining operations.

Capital Resources

During 2006, pre-commercial production began at the Redstone Mine. At that time, the Company relied on a mining contracting company to perform all duties associated with the dewatering, rehabilitation, mining, ramp development and site administration. During the year, the Company began to acquire sufficient equipment and personnel to perform these activities without the need of an external contractor. As a result, during the year the Company purchased $3,575,606 of mining, buildings and office equipment.

During 2006, the Company began construction of the Redstone Mill and Tailings Facility and during the year incurred $5,109,888 of construction costs. At year end, the mill and tailings facility remained under construction and the Company believes construction will be completed in Q2 of 2007.

The Company has the following contractual obligations:

	Payments Due by Period				
	Total	< 1 yr.	1-3 yrs.	4-5 yrs.	> 5 yrs.
Capital leases	$969,303	$413,657	$555,646	$nil	$nil
Operating leases	$132,134	$52,592	$79,542	$nil	$nil
Property acquisition obligations	$483,000	$170,000	$183,000	$130,000	$nil
Purchase obligations	$2,028,727	$2,028,727	$nil	$nil	$nil
Total	$3,613,164	$2,664,976	$818,188	$130,000	$nil

In addition the Company: has contractual obligations from property acquisition agreements to issue 125,000 common shares, 200,000 share purchase warrants and $200,000 worth of common shares and is committed to spending approximately $3,506,000 on exploration costs during 2007 as part of the flow through funding agreements completed during 2006.

Related Party Transactions

All transactions with related parties have occurred in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

A mining contract corporation owned by Mr. Daniel Dumas, a director of the Company, was paid $6,606,615 (2005 - $1,878,968) for dewatering and rehabilitation of the Redstone Mine and additional mining and ramp construction

services. At year end, $2,276,806 (2005 - $678,584) was included in accounts. Mr. Dumas' corporation continues to provide mining and ramp construction services.

Corporations controlled by Mr. Steven Anderson, a director of the Company, a Mr. Don McKinnon a former director of the Company, and the former President of the Company, were paid $100,939 (2005 - $104,081) and $nil (2005 - $5,850) respectively, for exploration, geological and staking services. Mr. Anderson's corporation continues to provide exploration, geological and staking services.

Professional fees of $nil (2005 - $9,510) were paid to a partnership in which a former director is a partner. This partnership no longer provides services to the Company.

Consulting fees for management services of $130,000 (2005 - $60,000) were paid to a corporation controlled by Mr. Gary Nash, the President of the Company, fees of $7,153 (2005 - $nil) were paid to Mr. Carlo Cattarello, a director of the Company and $nil (2005 - $52,500) of fees were paid to a corporation controlled by the former CFO. Mr. Nash and Mr. Cattarello continue to provide management services.

Financial Instruments

Fair Value

Canadian generally accepted accounting principles require that the Company disclose information about the fair value of its financial assets and liabilities. Fair value estimates are made at the balance sheet date based on relevant market information and information about the financial instrument. These estimates are subjective in nature and involve uncertainties in significant matters of judgement and therefore cannot be determined with precision. Changes in assumptions could significantly affect these estimates. The carrying amounts for amounts receivable, accounts payable and accrued liabilities and site restoration liability on the balance sheet approximate fair market value because of the limited term of these instruments.

Commodity Price Risk

The ability of the Company to develop its properties and the future profitability of the Company is directly related to the market price of certain metals.

Outstanding Share Data

	At December 31, 2006	At April 26, 2007
Common shares	56,646,085	63,244,565
Options	2,780,640	3,445,640
Warrants	4,154,126	2,929,698
Total	63,580,851	69,619,903

Risks and Uncertainties

As an exploration Company goes through a transition to become a mining Company, it is subject to many new risks and uncertainties. The mineral exploration business is risky and most exploration projects will not become mines. The Company may offer other mining companies the opportunity to acquire interests in any of its mineral assets in return for funding by such companies of all or part of the exploration and development of such assets. For the funding of any property acquisitions or exploration conducted by the Company, the Company may depend on the issue of shares from treasury to investors. Such financing will depend, in turn, on various factors, such as a positive mineral exploration climate, positive stock market conditions, the Company's track record and the experience of management. If such financing is unavailable for any reason, the Company may become unable to retain its mineral interests and carry out its business plan. The Company's exploration operations are subject to government legislation, policies and controls relating to prospecting, development, production, environmental protection, mining taxes and labour standards. In addition, the profitability of any prospect is directed by the market for minerals, which is influenced by many factors including changing production costs, supply and demand, inflation, and the political environment. The Company's success is dependent on the knowledge and expertise of its management and employees and their ability to identify and advance attractive exploration projects and targets. The competition for highly qualified personnel is strong and there is no guarantee that the Company will be able to retain or attract such personnel.

Mining Industry

The exploration for and development of mineral deposits involves significant risks which even a combination of careful evaluation, experience and knowledge may not eliminate. While the discovery of an ore body may result in

substantial rewards, few of the properties explored are ultimately developed into producing mines. Major expenses may be required to establish ore reserves, to develop metallurgical processes and to construct mining and processing facilities at a particular site. It is impossible to ensure that the current exploration programs planned by the Company will result in a profitable commercial mining operation.

Whether a mineral deposit will be commercially viable depends on a number of factors, such as particular attributes of the deposit, including size, grade and proximity to infrastructure. In addition, metal prices are highly cyclical and government regulations relating to prices, taxes, royalties, land tenure, land use, importing and exporting of minerals and environmental protection are subject to change and uncertainty. The combination of these factors may result in the Company not receiving an adequate return on invested capital. Mining operations generally involve a high degree of risk. The Company's operations are subject to the hazards and risks normally encountered in the exploration, development and production of ore. These include unusual and unexpected geology formations, rock bursts, cave-ins, flooding and other conditions involved in the drilling and removal of material, any of which could result in damage to, or destruction of, mines and other producing facilities, damage to life or property, environmental damage and possible legal liability. Although adequate precautions will to taken to minimize risk, milling operations are subject to hazards such as equipment failure or failure of retaining dams around tailings disposal areas which may result in environmental pollution and consequent liability.

The Company's activities are directed toward the search, evaluation and development of mineral deposits. Some of the mineral properties in which the Company has an interest contain no known body of commercial ore and any exploration programs thereon are exploratory searches for ore. Other properties in which the Company has an interest are subject to preliminary stages of exploration and development programs only. There is no certainty that the expenditures to be made by the Company as described herein will result in discoveries of commercial quantities of ore. Within the mining industry there is aggressive competition for the discovery and acquisition of properties considered to have commercial potential. The Company will compete with other interests, many of which have greater financial resources than it will have for the opportunity to participate in promising projects. Significant capital investment is required to achieve commercial production from successful exploration efforts.

Uncertainty of Reserve and Resource Estimates

The figures for reserves and resources presented herein are estimates and no assurance can be given that the anticipated tonnages and grades will be achieved or that the expected level of recovery will be realized. The ore grade actually recovered may differ from the estimated grades of the reserves and resources. Such figures have been determined based upon assumed metal prices and operating costs. Future production could differ dramatically from reserve estimates for, among reasons:

• Mineralization or formations could be different from those predicted by drilling, sampling and similar examinations.
• Increases in operating mining costs and processing costs could adversely affect reserves.
• The grade of the reserves may vary significantly from time to time and there is no assurance that any particular level of metals may be recovered from the ore.
• Declines in the market price of the metals may render the mining of some or all of the reserve uneconomic.

Any of these factors may require the Company to reduce its reserves estimates or increase its costs. Short-term factors such as the need for the additional development of a deposit or the processing of new different grades may impair the Company's profitability. Should the market price of the metals fall, the Company could be required to materially write down its investment in mining properties or delay or discontinue production or development of new projects.

Government Regulation

The exploration activities of the Company are subject to various federal, provincial and local laws governing prospecting, development, production, taxes, labour standards and occupational health, mine safety, toxic substance and other matters. Exploration activities are also subject to various federal, provincial and local laws and regulations relating to the protection of the environment. These laws mandate, among other things, the maintenance of air and water quality standards, and land reclamation. These laws also set forth limitations on the generation, transportation, storage and disposal of solid and hazardous waste. Although the Company's exploration activities are currently carried out in accordance with all applicable rules and regulations, no assurance can be given that new rules and regulations will not be enacted or that existing rules and regulations will not be applied in a manner which could limit or curtail production or development. Amendments to current laws and regulations governing operations and activities of exploration, mining and milling or more stringent implementation thereof could have a substantial adverse impact on the Company. Government approvals and permits are currently, and may in the future be, required in connection with the Company's operations. To the extent such approvals are required and not obtained, the Company may be curtailed or prohibited from proceeding with planned exploration or development of mineral properties. Failure to comply with applicable laws, regulations and permitting requirements may result in

enforcement actions there under, including orders issued by regulatory or judicial authorities causing operations to cease or be curtailed, and may include corrective measures requiring capital expenditures, installation of additional equipment, or remedial actions. Parties engaged in mining operations may be required to compensate those suffering loss or damage by reason of the mining activities and may have civil or criminal fines or penalties imposed for violations of applicable laws or regulations. Amendments to current laws, regulations and permits governing operations and activities of mining companies, or more stringent implementation thereof, could have a material adverse impact on the Company and cause increases in exploration expenses, capital expenditures or production costs or reductions in levels of production at producing properties or could require abandonment or delays in development of new mining properties.

Permits and Licenses

The exploitation and development of mineral properties may require the Company to obtain regulatory or other permits and licenses from various governmental licensing bodies. There can be no assurance that the Company will be able to obtain all necessary permits and licenses that may be required to carry out exploration, development and mining operations on its properties.

Environmental Risks and Hazards

All phases of the Company's operations are subject to environmental regulation in the various jurisdictions in which it operates. Environmental legislation is evolving in a manner which will require stricter standards and enforcement, increased fines and penalties for non-compliance, more stringent environmental assessments of proposed projects and a heightened degree of responsibility for companies and their officers, directors and employees. There is no assurance that future changes in environmental regulation, if any, will not adversely affect the Company's operations. Environmental hazards may exist on the properties on which the Company holds interests which are unknown to the Company at present which have been caused by previous or existing owners or operators of the properties. The Company may become liable for such environmental hazards caused by previous owners and operators of the properties even where it has attempted to contractually limit its liability. Production of mineral properties may involve the use of dangerous and hazardous substances. While all steps will be taken to prevent discharges of pollutants into the ground water the environment, the Company may become subject to liability for hazards that cannot be insured against.

Commodity Prices

The profitability of the Company will be significantly affected by changes in market price for nickel and cobalt by changes in the US Canadian exchange rate. The Company has not entered into any hedge agreements in respect of metal or foreign exchange at this time. Such contracts would mitigate gains and losses in situations when the price changed. The level of interest rates, the rate of inflation, world supply and demand of base metals and precious metals and stability of exchange rates can all cause significant fluctuations in base metal and precious metal prices. Such external economic factors are in turn influenced by changes in international investment patterns and monetary systems and political developments. The price of base metals and precious metals has fluctuated widely in recent years, and future serious price declines could cause continued commercial production to be impracticable. Depending upon the price of base metals and precious metals, cash flow from mining operations may not be sufficient to cover operating costs. Any figures for reserves presented by the Company will be estimates and no assurance can be given that the anticipated tonnages and grades will be achieved or that the indicated level of recovery will be realized. Market fluctuations and the price of base metals and precious metals may render reserves uneconomical. Moreover, short term operating factors relating to the reserves, such as the need for orderly development of the ore bodies or the processing of new or different grades of ore, may cause a mining operation to be unprofitable in any particular accounting period.

Uninsured Risks

The Company will carry insurance to protect against certain risks in such amounts as it considers adequate. Risks not insured against include environmental pollution or other hazards against which the Company cannot insure or against which it has elected not to insure.

Disclosure Controls and Internal Controls over Financial Reporting

Disclosure Controls

Multilateral Instrument 52-109 requires the CEO and CFO to certify that they are responsible for establishing and maintaining disclosure controls for the Company, that disclosure controls have been designed to provide reasonable assurance that material information relating to the Company is made known to them, that they have

evaluated the effectiveness of the Company's disclosure controls, and that their conclusions about the effectiveness of those disclosure controls at the end of the period covered by the relevant annual filings have been disclosed. The Company's CEO and CFO have evaluated the effectiveness of the Company's disclosure controls as at December 31, 2006 and concluded that those disclosure controls were effective for the year then ended.

Internal Controls over Financial Reporting

Multilateral Instrument 52-109 also requires the CEO and CFO to certify that they are responsible for establishing and maintaining internal controls over financial reporting, that these internal controls have been designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with Canadian GAAP, and that the Company has disclosed any changes in these internal controls during the most recent interim period that has materially affected, or is reasonably likely to materially affect, financial reporting. During 2006, the Company's management including the CEO and CFO, established, maintained and designed internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP. The Company's management including the CEO and CFO confirm there were no changes during the three months ended December 31, 2006 which materially affected, or are reasonably likely to materially affect, these controls.

Forward Looking Statements

Certain statements included in this MD&A are 'forward-looking statements'. These statements are based on the opinions and estimates of management at the date the statements are made, and are subject to a variety of risks and uncertainties and other factors that could cause actual events or results to differ materially from those projected in the forward-looking statements. These factors include, but are not limited to, the inherent risks involved in the interpretation of drill results, the geology, grade and continuity of mineral deposits and conclusions of economic evaluations, forecast levels of production and milling of ore, metallurgical recovery rates, metal prices, currency exchange rates, cash operating margins, cash operating cost per pound of metal sold, costs per ton of ore, expenditures on property, plant and equipment, increases and decreases in reserves and/or resources and anticipated grades and recovery rates and are or may be based on assumptions and/or estimates related to future economic, market and other conditions and other factors. The Company disclaims any obligation to update or revise any forward-looking statements if circumstances or management's estimates or opinions should change. Actual results may differ materially from those anticipated. The reader is cautioned not to place undue reliance on forward-looking statements due to their inherent uncertainty.

Additional Information

Additional information about Liberty Mines Inc. may be obtained from the Company's website at www.libertymines.com or on SEDAR at www.sedar.com.

LIBERTY MINES INC.
(A Development Stage Company)

CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2006 AND 2005

LIBERTY MINES INC.
(A Development Stage Company)

CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2006 AND 2005

McGovern, Hurley, Cunningham, LLP
Chartered Accountants

AUDITORS' REPORT

To the Shareholders of
LIBERTY MINES INC.
(A Development Stage Company)

We have audited the consolidated balance sheets of Liberty Mines Inc. (A Development Stage Company) as at December 31, 2006 and 2005 and the consolidated statements of operations and deficit and cash flows for each of the years in the two-year period ended December 31, 2006. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2006 and 2005 and the results of its operations and its cash flows for each of the years in the two-year period ended December 31, 2006 in accordance with Canadian generally accepted accounting principles.

McGOVERN, HURLEY, CUNNINGHAM, LLP

McGovern, Hurley, Cunningham, LLP

Chartered Accountants
Licensed Public Accountants

TORONTO, Canada
March 30, 2007

2005 Sheppard Avenue East, Suite 300, Toronto, Ontario, Canada, M2J 5B4
Telephone: (416) 496-1234 – Fax: (416) 496-0125 – E-Mail: info@mhc-ca.com – Website: www.mhc-ca.com

LIBERTY MINES INC.
(A Development Stage Company)
CONSOLIDATED BALANCE SHEETS
AS AT DECEMBER 31

	2006 $	2005 $
ASSETS		
CURRENT		
Cash and cash equivalents	1,267,553	531,866
Amounts recoverable	621,191	214,012
Prepaid expenses and deposits	136,311	21,461
	2,025,055	767,339
CONSTRUCTION AND EQUIPMENT DEPOSITS	1,800,026	200,165
MINERAL PROPERTIES AND DEFERRED EXPLORATION AND DEVELOPMENT EXPENDITURES (Note 4)	14,883,006	5,292,947
RECLAMATION DEPOSIT (Note 6)	608,962	73,362
BUILDINGS AND EQUIPMENT (Note 3)	9,001,651	435,639
	28,318,700	6,769,452
LIABILITIES		
CURRENT		
Bank indebtedness	432,219	-
Accounts payable and accrued liabilities (Note 9(a))	5,544,682	775,941
Current portion of long-term debt (Note 7)	413,657	-
Advance from customer (Note 5)	4,486,790	-
	10,877,348	775,941
SITE RESTORATION OBLIGATIONS (Note 6)	142,000	94,000
LONG-TERM DEBT (Note 7)	555,646	-
FUTURE INCOME TAX LIABILITY (Note 12(b))	260,000	30,000
	11,834,994	899,941
SHAREHOLDERS' EQUITY		
CAPITAL STOCK (Notes 8(a) and (b))	17,633,138	6,974,905
WARRANTS (Note 8(d))	817,920	393,653
CONTRIBUTED SURPLUS (Note 8(e))	997,763	948,266
DEFICIT	(2,965,115)	(2,447,313)
	16,483,706	5,869,511
	28,318,700	6,769,452

COMMITMENTS AND CONTINGENCIES (Notes 1, 4, 5 and 10)

APPROVED ON BEHALF OF THE BOARD:

Signed *"Gary Nash"*,
Director

Signed *"Don Schurman"*,
Director

See accompanying notes to the consolidated financial statements.

LIBERTY MINES INC.
(A Development Stage Company)
CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT
FOR THE YEARS ENDED DECEMBER 31

	2006 $	2005 $
EXPENSES		
Salaries and benefits	82,590	19,192
Office and general	216,617	28,831
Consulting fees and directors compensation	290,884	554,856
Foreign exchange loss	149,299	-
Accretion of site restoration obligation	6,580	6,100
Investor relations	92,427	61,874
Rent	-	3,456
Professional fees	126,228	54,411
Travel and promotion	36,940	22,075
Insurance	49,083	4,932
Vehicle	-	3,583
Interest and bank charges	40,325	-
Interest on long-term debt	24,386	-
Stock exchange and trustee fees	23,045	30,982
General exploration	3,846	2,762
Loss before the undernoted	1,142,250	793,054
Interest and investment income	(33,005)	(6,282)
Loss on sale of marketable securities	-	5,050
Loss before income taxes	1,109,245	791,822
Future income taxes (Note 12(a))	(591,443)	(135,320)
NET LOSS FOR THE YEAR	517,802	656,502
DEFICIT, beginning of year	2,447,313	1,790,811
DEFICIT, end of year	2,965,115	2,447,313
LOSS PER SHARE - Basic and diluted	0.01	0.02
WEIGHTED AVERAGE NUMBER OF COMMON SHARES	45,577,642	31,869,198

See accompanying notes to the consolidated financial statements.

LIBERTY MINES INC.
(A Development Stage Company)
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31

	2006 $	2005 $
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss for the year	(517,802)	(656,502)
Adjustments for:		
Loss on sale of marketable securities	-	5,050
Stock-based compensation	96,500	449,856
Accretion of site restoration obligation	6,580	6,100
Future income tax recovery	(591,443)	(135,320)
	(1,006,165)	(330,816)
Change in non-cash working capital items:		
Prepaid expenses and deposits	(114,850)	(21,461)
Amounts recoverable	(407,179)	(124,709)
Accounts payable and accrued liabilities	139,742	(5,571)
Cash flows from operating activities	(1,388,452)	(482,557)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Advance from customer, net of repayments	4,486,790	-
Issuances of capital stock, net of costs	10,591,038	3,156,347
Increase in capital leases, net of repayments	969,303	-
Exercise of options and warrants	1,089,238	104,391
Cash flows from financing activities	17,136,369	3,260,738
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sale of property	-	12,000
Proceeds from sale of marketable securities	-	34,950
Increase in equipment deposits	(1,599,861)	-
Increase in deferred exploration and development expenditures	(5,206,880)	(1,927,714)
Increase in reclamation deposit	(535,600)	(5,462)
Purchase of equipment	(8,102,108)	(429,043)
Cash flows from investing activities	(15,444,449)	(2,315,269)
Increase in cash and cash equivalents	303,468	462,912
Cash and cash equivalents, beginning of year	531,866	68,954
Cash (bank indebtedness) and cash equivalents, end of year	835,334	531,866
CASH (BANK INDEBTEDNESS) AND CASH EQUIVALENTS CONSISTS OF:		
(Bank indebtedness) cash	(432,219)	31,866
Cash equivalents	1,267,553	500,000
	835,334	531,866
SUPPLEMENTAL INFORMATION:		
Investor warrants granted	682,549	224,817
Broker warrants granted	291,982	140,749
Issuance of shares for property acquisition	137,000	-
Interest paid	24,385	3,659
Income taxes paid	-	-
Increase in accounts payable netted against deferred exploration and development expenditures	4,043,962	687,140

See accompanying notes to the consolidated financial statements.

1. NATURE OF OPERATIONS AND GOING CONCERN

Liberty Mines Inc. (the "Company") a development stage company is in the process of exploring and developing its mineral properties. The Company is now at the pre-production stage on those properties with economically recoverable ore reserves. The Company has also undertaken to build a nickel processing facility which is currently being constructed.

The business of mining and exploring for minerals involves a high degree of risk and there can be no assurance that current exploration programs will result in profitable mining operations. The recoverability of amounts shown for mineral properties and related deferred exploration and development costs is dependant upon a discovery of economically recoverable reserves, confirmation of the Company's interest in the underlying mineral claims, the ability of the Company to obtain necessary financing to complete the development and future profitable production or, alternatively, upon disposition of such properties at a profit. Changes in future conditions could require material writedowns of the carrying values of mineral properties and deferred exploration costs.

Although the Company has taken steps to verify title to the properties on which it is conducting exploration and in which it has an interest, in accordance with industry standards for the current stage of exploration of such properties, these procedures do not guarantee the Company's title. Property title may be subject to unregistered prior agreements, aboriginal claims and non-compliance with regulatory requirements.

The Company has a need for equity capital and financing for working capital requirements. Because of limited working capital and continuing operating losses, the Company's continuance as a going concern is dependent upon its ability to obtain adequate financing and to reach profitable levels of operation. It is not possible to predict whether financing efforts will be successful or if the Company will attain profitable levels of operations.

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles applicable to a going concern. Accordingly, they do not give effect to adjustments that would be necessary should the Company be unable to continue as a going concern and therefore be required to realize its assets and liquidate its liabilities and commitments in other than the normal course of business and at amounts different from those in the accompanying consolidated financial statements.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of the Company and its subsidiaries are in accordance with Canadian generally accepted accounting principles ("GAAP") and their basis of application is consistent with that of the previous year. Outlined below are those policies considered particularly significant:

(a) **Basis of consolidation:**
The consolidated financial statements include the accounts of the Company and its two wholly owned subsidiaries, Liberty Cobalt Inc. and 204428 Ontario Inc.

(b) **Stock-Based Compensation:**
The Company records compensation cost based on the fair value method of accounting for stock based compensation. The fair value of stock options is determined using the Black-Scholes option pricing model. The fair value of the options is recognized over the vesting period as compensation expense and contributed surplus. When options are exercised, the proceeds received, together with any related amount in contributed surplus, will be credited to capital stock.

(c) **Cash and Cash Equivalents:**
Cash and cash equivalents consists of cash on hand, and short-term deposits which generally mature within 90 days from the date of acquisition.

Continued...

2. **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

(d) **Site Restoration Obligations:**
The Company will record a liability for the estimated future costs associated with legal obligations relating to the reclamation and closure of its exploration properties. This amount is initially recorded at its discounted present value with subsequent annual recognition of an accretion amount on the discounted liability. An equivalent amount is recorded as an increase to exploration properties and deferred exploration expenditures and amortized over the useful life of the properties.

(e) **Buildings and Equipment:**
Buildings and equipment are recorded at cost. Amortization is provided for as follows:

Mill and tailings facility	Straight-line basis over 30 year useful life
Buildings	10% Straight-line basis
Machinery and equipment	30% Declining-balance basis
Office furniture and equipment	20% Declining-balance basis
Computer software and equipment	50% Declining-balance basis

(f) **Mineral properties and deferred exploration and development expenditures:**
The cost of mineral properties and deferred exploration and development expenditures are carried at cost until they are brought into production, at which time they are depleted on a unit-of-production method based on proven and probable reserves. If a property is subsequently determined not to be economic, the property and related deferred costs are written down to net realizable value. Other general exploration expenses are charged to operations as incurred. The cost of exploration properties abandoned or sold and their related deferred exploration costs are charged to operations in the current year.

The Company reviews its mineral properties to determine if events or changes in circumstances have transpired which indicate that the carrying value of its assets may not be recoverable. The recoverability of costs incurred on the exploration properties is dependent upon numerous factors including exploration results, environmental risks, commodity risks, political risks, and the Company's ability to attain profitable production. An impairment loss is recognized when the carrying value of the mineral properties is not recoverable and exceeds its fair value. It is reasonably possible, based on existing knowledge, that changes in future conditions in the near-term could require a change in the determination of the need for, and amount of, any write down.

Costs include the cash consideration and the fair market value of the shares issued for the acquisition of mineral properties. The carrying value is reduced by option proceeds received until such time as the property cost and deferred expenditures are reduced to nominal amounts. Properties acquired under option agreements or by joint ventures, whereby payments are made at the sole discretion of the Company, are recorded in the accounts at the time of payment.

(g) **Flow-through financing:**
The Company has financed a portion of its exploration activities through the issuance of flow-through shares, which transfer the tax deductibility of exploration expenditures to the investor. Proceeds received on the issuance of such shares have been credited to capital stock and the related exploration costs have been charged to exploration properties and deferred exploration expenditures.

Resource expenditure deductions for income tax purposes related to exploration and development activities funded by flow-through share arrangements are renounced to investors in accordance with income tax legislation. When these expenditures are renounced, temporary taxable differences created by the renunciation will reduce share capital and increase future tax liabilities.

Continued…

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(h) Income taxes:
The Company follows the asset and liability method of accounting for income taxes. Under this method, future income tax assets and liabilities are determined based on differences between the financial statement carrying values and the income tax bases of assets and liabilities, and are measured using the substantively enacted income tax rates and laws that are expected to be in effect when the temporary differences are expected to reverse. The effect on future income tax assets and liabilities of a change in income tax rates is recognized in the period that includes the date of enactment or substantive enactment of the change. When the future realization of income tax assets does not meet the test of being more likely than not to occur, a valuation allowance in the amount of the potential future benefit is taken and no net asset is recognized.

(i) Loss per share:
Basic loss per share is calculated using the weighted average number of shares outstanding. Diluted loss per share is calculated using the treasury stock method. In order to determine diluted loss per share, the treasury stock method assumes that any proceeds from the exercise of dilutive stock options and warrants would be used to repurchase common shares at the average market price during the period, with the incremental number of shares being included in the denominator of the diluted loss per share calculation. The diluted loss per share calculation excludes any potential conversion of options and warrants that would increase earnings per share or decrease loss per share.

(j) Use of estimates:
The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Such estimates and assumptions affect the carrying value of assets, impact decisions as to when exploration and development costs should be capitalized or expensed, and estimates for asset retirement obligations and reclamation costs. Other significant estimates made by the Company include factors affecting valuations of stock-based compensation, warrants, brokers' warrants, asset retirement obligations and income tax accounts. The Company regularly reviews its estimates and assumptions, however, actual results could differ from these estimates and these differences could be material.

(k) Foreign currency translation:
Monetary assets and monetary liabilities in foreign currencies have been translated at exchange rates in effect at the balance sheet date. Revenue and expense transactions are translated at average exchange rates during the year. Exchange gains or losses from such translation practices are reflected in the income statement.

(l) Comparative figures:
Certain comparative figures have been reclassified to conform with presentation adopted in the current period.

3. BUILDINGS AND EQUIPMENT

	Cost	Accumulated Amortization	2006 Net
	$	$	$
Mill and tailings facilities	5,109,888	-	5,109,888
Buildings	515,802	5,358	510,444
Machinery and equipment	1,743,064	58,888	1,684,176
Machinery and equipment under capital lease	1,635,811	51,160	1,584,651
Office furniture and equipment	13,513	829	12,684
Computer software and equipment	104,705	4,897	99,808
	9,122,783	121,132	9,001,651

At December 31, 2006 the mill and tailings facilities were still under construction and not ready for use, therefore amortization was not taken on these items. Amortization on certain machinery and equipment and buildings used in exploration and development activities totaling $121,132 (2005 - $Nil) was capitalized to mineral properties and deferred exploration and development expenditures.

	Cost	Accumulated Amortization	2005 Net
	$	$	$
Buildings	34,158	-	34,158
Machinery and equipment	393,827	1,650	392,177
Office equipment	9,304	-	9,304
	437,289	1,650	435,639

4. MINERAL PROPERTIES AND DEFERRED EXPLORATION AND DEVELOPMENT EXPENDITURES

Property	Balance December 31, 2004 $	Net Additions/ Recoveries $	Balance December 31, 2005 $	Net Additions/ Recoveries $	Balance December 31, 2006 $
McAra Property (a)					
Acquisition	199,000	90,000	289,000	65,078	354,078
Exploration and development	147,453	30,874	178,327	237,743	416,070
Redstone Nickel Project (b)					
Acquisition	1,184,513	-	1,184,513	-	1,184,513
Exploration and development	12,480	2,154,433	2,166,913	8,689,879	10,856,792
Northern Claims (McWatters) (c)					
Acquisition	450,000	-	450,000	100,000	550,000
Exploration and development	678,351	82,399	760,750	147,568	908,318
Shaw Dome Project (d)					
Acquisition	51,002	-	51,002	2,667	53,669
Exploration	147,460	21,082	168,542	16,407	184,949
Ray Township (e)					
Acquisition	-	28,415	28,415	-	28,415
Exploration	-	-	-	28,850	28,850
West Redstone Claims (f)					
Acquisition	-	-	-	86,257	86,257
Exploration	-	-	-	24,210	24,210
Hart Nickel Property (g)					
Acquisition	-	-	-	177,000	177,000
Exploration	-	-	-	14,400	14,400
Cody/Bristol Projects (h)					
Acquisition	60,000	(52,000)	8,000	-	8,000
Exploration	-	7,485	7,485	-	7,485
	2,930,259	2,362,688	5,292,947	9,590,059	14,883,006

(a) The McAra Lake Property was acquired on December 31, 2003 and is located in Dufferin Township, south of Shining Tree, Ontario. The property is subject to an option agreement that required payments of $25,000 every six months from February 2004 - 2006. The property is also subject to a 3% net smelter return ("NSR"). During 2006, the final option payment of $25,000 was made. During 2005, an additional 64 claims surrounding the original McAra property were optioned for an initial payment of $40,000. In addition, the following payments are required:

- $40,000 on or before August 25, 2006 (paid); and
- $40,000 on or before August 25, 2007.

One of the additional claims is subject to a 1.5% NSR.

4. EXPLORATION PROPERTIES AND DEFERRED EXPLORATION EXPENDITURES (Continued)

(b) The Redstone Nickel Project was acquired on December 31, 2003 through the acquisition of Timmins Metals Corp ("TMC"). This project is located in Eldorado Township, Ontario. The property is subject to a 2% NSR to a maximum of $336,000. Inco Ltd. ("Inco") held an option to earn a 70% interest in the property by paying TMC a total of $520,000 over a four-year period, of which $105,000 was paid during the first two years of the agreement. On November 8, 2004, this option agreement was relinquished. As consideration, Inco received $250,000 and 2,000,000 shares of the Company valued at $400,000. Also, Inco has been granted the first right of refusal on any concentrates produced from this project from January 1, 2012 - December 31, 2014. In 2005, the Company received permission from the Ministry of Northern Development and Mines to reactivate the mine. The Company continues to develop the underground workings but has not yet reached commercial production.

(c) The Company holds a 100% interest in certain mining claims in Northern Ontario. This group of properties contains the McWatters project. During 2006, the Company acquired additional claims for $100,000.

(d) The Shaw Dome nickel / platinum properties consist of various claims south of Timmins, Ontario. The properties are subject to a 3% NSR.

(e) Ray township properties were acquired for the staking cost of $28,415 from two directors of the Company. These properties consist of 19 claims (275 units) contiguous to the east and north of the McAra Lake claims.

(f) The West Redstone 104 mining claim options were acquired on trend with the Redstone Mine. These claims were acquired during 2006 for a cost of 100,000 shares valued at $60,000 (based on the quoted market value at the date of issue), plus $1,257 in expenses and a cash payment of $25,000. In addition, the following payments and share issuances are required:

- pay $30,000 on or before June 5, 2007;
- pay $36,000 and issue 50,000 shares of the Company on or before June 5, 2008;
- pay $47,000 on or before June 5, 2009;
- pay $60,000 and issue 25,000 shares of the Company on or before June 5, 2010; and
- pay $70,000 and issue 50,000 shares of the Company on or before June 5, 2011.

The Company is also subject to an annual work commitment of $100,000 per year for five years. Staking and geophysics were conducted on the adjacent properties in the amount of $24,210.

(g) The Hart Nickel Property was acquired during 2006 for an initial payment of $100,000 plus 100,000 shares valued at $77,000 (based on the quoted market value at the date of issue). The Company will earn a 100% interest in the 11-unit group of contiguous mining claims by paying on the first and second anniversaries: i) an additional $100,000, ii) shares valued at $100,000 and iii) 100,000 warrants with a 1 year term with an exercise price based upon the 10 day trading price of the Company's shares at the date of grant.

(h) Cody/Bristol Gold Properties consist of various claims in the area of Timmins, Ontario. The properties are subject to a 3% NSR. In 2005, the Company sold certain claims in Bristol Township for $12,000 cash and 80,000 shares of TOM Exploration Inc. valued at $40,000. The proceeds of $52,000 were credited to the property cost. Geophysics work totalling $7,485 was carried out on the property prior to its sale.

5. ADVANCE FROM CUSTOMER

On April 18, 2006, Jilin Jien Nickel Industry Co. Ltd. ("JJ") (a Chinese corporation) advanced US$4,000,000 ($4,575,200) to assist in financing the construction of a mill necessary for the Company to supply concentrate to JJ. The advance is to be repaid in the amount of US$25,000 per month commencing May 31, 2006 until the mill has reached full production. After reaching full production, US$500,000 would be repaid monthly until full repayment of the advance is received. Any interest earned by unused funds on deposit is to be paid to JJ. The Company has provided security to JJ by pledging the claims on which the Redstone Mine is located and the provision of corporate guarantees. The term of the advance is one year. A finders' fee of 1.5% of the loan amount ($66,792) was paid upon receipt of the funds. At December 31, 2006, the construction of the mill was not complete and the mill was not in production. During 2006, US$150,000 ($169,160) of the advance was repaid.

6. SITE RESTORATION OBLIGATION

The asset retirement obligation relates to reclamation and closure costs relating to the Redstone Nickel Project and the Redstone Mill. The asset retirement obligation is calculated as the net present value of estimated future cash flows associated with closing costs, which are estimated to be approximately $100,000 and $535,600 for the mine and mill respectively. The obligation is discounted using a credit adjusted risk-free rate of 13%. The settlement of the obligation for the mine is estimated to take place in 2009 and the settlement of the obligation for the mill is estimated to take place in 2037. Construction of the mill began in 2006 and the mill remains under construction at year end. As a result, $70,281 has been added to the asset retirement obligation. Reclamation deposits totalling $608,962 ($73,362 for the mine and $535,600 for the mill) have been made.

The following is an analysis of the asset retirement obligation:

	2006	2005
	$	$
Opening balance	94,000	87,900
Accretion	6,580	6,100
Additions	41,420	-
Closing balance	142,000	94,000

7. LONG-TERM DEBT

The Company has financed the purchase of certain mining equipment through capital leases. The leases mature at various dates through October 2009 and bear interest from approximately 7% to 24%.

	2006	2005
	$	$
Obligations under capital leases	969,303	-
Less: current portion	(413,657)	-
Long-term portion of capital leases	555,646	-

8. CAPITAL STOCK

(a) Authorized:

Unlimited number of common shares
Unlimited number of preferred shares

(b) Issued:

	Number of shares #	Amount $
Balance, December 31, 2004	29,951,938	4,081,996
Private placements, net of expenses and warrants (i)	9,027,168	2,790,780
Options and warrants exercised	531,214	142,449
Renunciation of flow-through expenditures	-	(40,320)
Balance, December 31, 2005	39,510,320	6,974,905
Private placements, net of expenses and warrants (ii)	13,763,051	9,910,211
Options and warrants exercised	3,172,714	1,432,465
Acquisition of exploration properties	200,000	137,000
Renunciation of flow-through expenditures	-	(821,443)
Balance, December 31, 2006	56,646,085	17,633,138

(i) On July 15, 2005, the Company completed a private placement of 2,160,999 units at a price of $0.22 per share. Each unit consisted of one common share and one-half of one common share purchase warrant. Each whole warrant entitles the holder to purchase one common share of the Company at a price of at $0.25 until January 15, 2007. Finder's fees of 8% and other issue costs are deducted from the proceeds. 209,964 broker warrants were issued. Each broker warrant is exercisable into one common share at $0.25 until January 15, 2007. The Black-Scholes option pricing model was used to determine the fair value of the warrants and broker warrants using the following weighted average assumptions: expected dividend yield of 0%; risk-free interest-rate of 4.5%; expected volatility of 80%; expected life of 1.5 years. The warrants have been valued at $101,237.

On November 25, 2005, the Company completed a private placement of 5,070,639 flow-through shares at a price of $0.45 per share and 1,795,530 non-flow-through units ("Units") at a price of $0.40 per Unit. Each Unit consisted of one common share and one-half of one common share purchase warrant. Each whole warrant entitles the holder to purchase one common share of the Company at a price of $0.50 until November 25, 2007. The broker received 686,617 warrants, which entitle the holder to purchase one common share of the Company at a price of $0.40 until November 25, 2007. The broker was also paid a commission of 8% ($240,000). The Black-Scholes option pricing model was used to determine the fair market value of the warrants and broker warrants using the following assumptions: expected dividend yield of 0%; risk-free interest-rate of 4.5%; expected volatility of 80%; and expected life of 2 years. The warrants have been valued at $264,330.

8. CAPITAL STOCK (Continued)

(ii) On March 7, 2006 the Company completed a non-brokered private placement of 3,293,785 flow-through shares at $0.70 and 202,000 units at $0.65 consisting of one common share and one-half of one common share purchase warrant. Each whole warrant is exercisable into one common share of the Company at an exercise price of $0.85 for a period of two years. In the event the shares of the Company trade above $1.25 for 20 consecutive trading days, the conversion date is shortened to 30 days following the date of a press release announcing the new expiry date. Finder's fees of $151,781 were paid in connection with the private placement and 200,000 broker-warrants were issued having the same terms as the warrants issued. The Black-Scholes option pricing model was used to determine the fair market value of the warrants and broker warrants using the following assumptions: expected dividend yield of 0%; risk-free interest-rate of 3.98%; expected volatility of 114%; and expected life of 1 year. The warrants have been valued at $71,854. Directors of the Company subscribed for 101,000 flow-through shares.

On October 24, 2006 the Company completed a private placement of 6,350,266 flow-through shares at $0.90 per share and 3,917,000 units at $0.85 per unit, each unit consisting of one common share and one-half of one common share purchase warrant. Each whole warrant is exercisable into one common share of the Company at an exercise price of $1.00 for a period of two years. In the event the shares of the Company trade above $1.50 for 20 consecutive trading days, the conversion date is shortened to 30 days following the date of a press release announcing the new expiry date. The broker received 726,808 warrants, which entitle the holder to purchase one common share of the Company at a price of $1.00 until October 23, 2008. The broker was also paid a cash commission of $600,009. The broker warrants are also subject the same acceleration clause as the warrants issued. The Black-Scholes option pricing model was used to determine the fair market value of the warrants and broker warrants using the following assumptions: expected dividend yield of 0%; risk-free interest-rate of 4.11%; expected volatility of 76%; and expected life of 1 year. The warrants have been valued at $580,748. Directors of the Company subscribed for 284,222 flow-through shares.

(c) Stock Options:

The Board of Directors has approved a stock option plan for directors, officers, management, employees and consultants of the Company or any of its subsidiaries. The purpose of the plan is to attract, retain and motivate these parties by providing them with the opportunity, through share options, to acquire a proprietary interest in the Company and to benefit from its growth. The maximum number of common shares reserved for issuance upon the exercise of options is not to exceed ten percent of the total number of common shares outstanding immediately prior to such an issuance. The maximum number of common shares reserved for issuance to any one participant upon the exercise of options is not to exceed five percent of the total number of common shares outstanding immediately prior to such an issuance. The options are non-assignable and may be granted for a term not exceeding ten years. The exercise price of the options is fixed by the Board of Directors at the market price of the shares at the time of grant, subject to all applicable regulatory requirements. As at December 31, 2006, the Company had the following outstanding and exercisable stock options:

8. CAPITAL STOCK (Continued)

Expiry Date	Options Outstanding #	Options Exercisable #	Exercise Price $
March 8, 2007	25,000	25,000	0.70
October 2, 2008	100,000	100,000	0.12
November 12, 2008	88,640	88,640	0.31
February 12, 2009	280,000	280,000	0.58
September 30, 2009	125,000	125,000	0.20
June 6, 2010	600,000	600,000	0.20
June 20, 2010	605,000	605,000	0.22
November 25, 2010	50,000	50,000	0.50
December 1, 2010	500,000	500,000	0.57
April 13, 2011	300,000	100,000	0.62
July 16, 2011	25,000	25,000	0.81
October 1, 2011	25,000	25,000	0.81
October 12, 2007	47,000	47,000	0.95
November 26, 2011	10,000	10,000	1.50
Total options and weighted average exercise price	2,780,640	2,580,640	0.39

Stock option transactions for the respective years were as follows:

	2006		2005	
	Options #	Weighted Average Exercise Price $	Options #	Weighted Average Exercise Price $
Beginning of year	3,172,280	0.36	2,714,560	0.36
Granted	432,000	0.70	2,185,000	0.34
Exercised	(823,640)	0.42	(137,500)	0.15
Expired	-	-	(1,477,280)	0.38
Cancelled	-	-	(112,500)	0.22
	2,780,640	0.39	3,172,280	0.35

During the year ended December 31, 2006, the Company granted 432,000 (2,185,000 – 2005) stock options with a weighted average exercise price of $0.70 ($0.34 – 2005). The fair value of each option granted was determined using the Black-Scholes option pricing model and the following assumptions:

	2006	2005
Risk-free interest rate	3.9% – 4.3%	4.5%
Expected life	1 or 5 years	1,2 or 5 years
Expected volatility in the market price of the shares	73 – 106%	80 or 85%
Expected dividend yield	0%	0%

During the year ended December 31, 2006, $164,389 (2005 - $449,856) was credited to contributed surplus in respect of stock-based compensation. Of this amount, $96,500 was charged to consulting and directors compensation of the statement of operations, $39,665 was charged to mineral properties and deferred exploration and development expenditures on the balance sheet and $28,224 was charged to share issue costs which were netted against capital stock on the balance sheet.

8. CAPITAL STOCK (Continued)

(d) Warrants:

As at December 31, 2006, the Company had the following outstanding share purchase warrants.

Expiry Date	Warrants	Exercise Price	Black-Scholes Valuation
	#	$	$
January 15, 2007	100,001	0.25	7,845
November, 26 2007	737,200	0.50	115,003
November, 26 2007	631,617	0.40	114,323
October 24, 2008	2,685,308	1.00	580,749
	4,154,126	0.80	817,920

Share purchase warrant transactions for the respective years were as follows:

	2006		2005	
	Warrants	Weighted Average Exercise Price	Warrants	Weighted Average Exercise Price
	#	$	#	$
Beginning of year	3,716,892	0.35	2,551,500	0.28
Granted	2,986,308	0.98	2,915,106	0.37
Exercised	(2,349,074)	0.32	(393,714)	0.21
Expired	(200,000)	0.85	(1,356,000)	0.29
End of year	4,154,126	0.80	3,716,892	0.35

(e) Contributed Surplus:

Contributed surplus transactions for the respective years were as follows:

Balance, December 31, 2004	$ 497,000
Stock-based compensation - employees	406,876
Stock-based compensation - non-employees	42,980
Exercise of stock options	(9,750)
Expiry of broker warrants	11,160
Balance, December 31, 2005	948,266
Stock-based compensation - employees	136,165
Stock-based compensation - non-employees	28,224
Exercise of stock options	(162,555)
Expiry of broker warrants	47,663
Balance, December 31, 2006	$997,763

9. RELATED PARTY TRANSACTIONS

All transactions with related parties have occurred in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

(a) A mining contract corporation, owned by a former director of the Company, was paid $6,606,615 (2005 - $1,878,968), of which $2,276,806 (2005 - $678,584) was included in accounts payable and accrued liabilities at year-end.

(b) Exploration fees of $100,939 (2005 - $104,081) were paid to corporations controlled by directors of the Company.

(c) Professional fees of $nil (2005 - $9,510) were paid to a partnership in which a former director is a partner.

(d) Consulting fees of $130,000 (2005 - $60,000) were paid to a corporation controlled by the President of the Company, consulting fees of $7,153 (2005 - $nil) were paid to a director of the Company and $nil (2005 - $52,500) of consulting fees were paid to a corporation controlled by the former CFO.

10. COMMITMENTS AND CONTINGENCIES

(a) The Company is committed to minimum rentals under vehicle and equipment leases which expire at various dates through 2009. Minimum rental commitments under these leases approximate the following:

2007	$ 53,000
2008	49,000
2009	30,000
	$132,000

(b) The Company is committed to spending approximately $3,265,000 on exploration costs during 2007 as part of the flow-through funding agreements that were completed during 2006.

(c) Commitments for capital expenditures as at December 31, 2006 approximated $1,718,000.

(d) The Company has been named as a defendant in a legal action for approximately $150,000 allegedly owing in respect of work carried out by a company contracted by the Company. An additional sum of $100,000 is being claimed for damages. The Company has countersued for an amount of approximately $791,000 for breach of contract relating to delays, cost overruns and faulty equipment. Management believes that the action brought against the Company is without merit and plans to vigorously defend this claim. At the present time, it is not possible to determine the final amount, if any, that the Company may pay or receive related to these actions. Accordingly, no amounts relating to these lawsuits have been recorded in these consolidated financial statements.

11. FINANCIAL INSTRUMENTS

Fair Value:
Canadian generally accepted accounting principles require that the Company disclose information about the fair value of its financial assets and liabilities. Fair value estimates are made at the balance sheet date based on relevant market information and information about the financial instrument. These estimates are subjective in nature and involve uncertainties in significant matters of judgement and therefore cannot be determined with precision. Changes in assumptions could significantly affect these estimates.

The carrying amounts for amounts recoverable, accounts payable and accrued liabilities, current portion of long-term debt and advance from customer on the balance sheet approximate fair market value because of the limited term of these instruments. There were no material differences between the book value and fair value of long-term liabilities.

Commodity Price Risk:
The ability of the Company to develop its properties and the future profitability of the Company is directly related to the market price of certain minerals.

Foreign Exchange Risk:
The Company is subject to foreign exchange risk as some of its operating and investing activities are transacted in currencies other than the Canadian dollar, including the US dollar. The Company is therefore subject to gains and losses due to fluctuations in these currencies relative to the Canadian dollar.

12. INCOME TAXES

(a) Provision for income taxes
Major items causing the Company's income tax rate to differ from the Canadian combined federal and provincial statutory rate of approximately 36% (2005 - 36%) are as follows:

	2006 $	2005 $
Loss before income taxes	1,109,246	791,852
Expected income tax benefit based on statutory rates	399,000	285,000
Adjustments to benefit resulting from:		
Share issue costs	321,000	115,000
Stock-based compensation	(49,000)	(162,000)
Expiry of losses	-	(33,000)
Other	(79,557)	(69,680)
	591,443	135,320

(b) Future income tax balances
The tax effects of temporary differences that give rise to future income tax assets and future income tax liabilities at December 31 approximate the following:

	2006 $	2005 $
Future tax assets (liabilities)		
Resource properties	(553,000)	(549,000)
Share issue costs	293,000	115,000
Non-capital losses and other	-	404,000
Net future income tax liability	(260,000)	(30,000)

12. INCOME TAXES (Continued)

(c) Tax loss carry-forwards

The Company has approximately $12,992,000 of cumulative Canadian development expenses and cumulative Canadian exploration expenses at December 31, 2006 which, under certain circumstances, may be utilized to reduce Canadian taxable income of future years.

13. SUBSEQUENT EVENTS

In February 2007, the Company completed a brokered financing for gross proceeds of $12,100,000 by the issue of 1,851,900 flow through common shares and 1,800,000 units, with each unit consisting of one common share and one-half of one common share purchase warrant.

On March 26, 2007, the Company announced that conditions had been met for the early exercise of the unexercised 2,685,308 investor warrants and broker warrants that were unexercised at December 31, 2006. The warrants are exercisable at $1.00 and will expire on April 25, 2007.

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John Pinsent BComm. CA, Edmonton, Alberta

Gerry Feldman BA BComm.(Hons) CA, Toronto, Ontario

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Officers

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